Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author:	Fuentes	Analyst:	Jahna Alvarado	Bill Number:	AB 152
Related Bills:	See Prior Analysis	Telephone:	845-5683	Amended Date:	May 27, 2011
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Donations Of Fresh Fruits Or Fresh Vegetables To Food Bank Credit/ Emergency Food Assistance Program Fund/ FTB To Report Credit Utilization To Legislature

SUMMARY

This bill would create an income tax credit for donations of fresh fruits or fresh vegetables to a California food bank.

This analysis will not address the bill's changes to the Health and Safety Code or Welfare and Institutions Code, as they do not impact the department or state income tax revenue.

RECOMMENDATION AND SUPPORTING ARGUMENTS

No position.

SUMMARY OF AMENDMENTS

The May 27, 2011, amendments resolved the department's technical considerations by accepting the amendments suggested in the department's April 14, 2011 analysis. Except for the technical considerations, clarification of the current federal and state law, and the fiscal impact discussion, the department's analysis of the bill as amended April 14, 2011, still applies.

The Federal/State Law section has been revised to clarify recent changes in federal law. The "Implementation Considerations" and "Economic Impact" sections are included below for convenience.

ANALYSIS

Under current federal and state laws, in general, all ordinary and necessary expenses of a trade or business are deductible. For taxpayers, including farmers, that are required to use an inventory method of accounting, certain business expenses are capitalized and, upon the sale of the underlying inventory, are deducted as "costs of goods sold." Inventories include all goods that are held for sale in the ordinary course of business or that are to become a physical part of goods for sale to customers in the ordinary course of business.

Board Position:			Asst. Legislative Director	Date
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There are four methods farmers use to value inventory: (1) the cost method; (2) the lower-of-cost-or-market method; (3) the farm price method; and (4) the unit-livestock-price method. The two most commonly recognized methods of valuing inventories are cost and the lower-of-cost-or-market, whichever is lower. Costs of goods on hand at the start of an accounting period are the amount at which they were valued in the closing inventory of the prior period. Costs of goods ordinarily purchased are the invoice price minus trade or other discounts. Costs of goods produced by the taxpayer include raw materials and supplies entering into or consumed in manufacturing, regular and overtime direct labor costs, and certain required indirect costs.

FEDERAL/STATE LAW

Under current federal law, in general, a deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization. The amount of any deduction generally equals the fair market value of the contributed property on the date of the contribution.

Under a federal special temporary provision,[1] for charitable contributions of food inventory made after December 31, 2009, and before January 1, 2012, a taxpayer engaged in a trade or business is eligible to claim an enhanced deduction for donations of food inventory.[2] In general, the total deduction for donations of food inventory in a taxable year may not exceed 10 percent of the taxpayer's net income for such taxable year.

The enhanced federal deduction for food is available only for food that qualifies as "apparently wholesome food." Apparently wholesome food is defined as food intended for human consumption that meets all quality and labeling standards imposed by federal, state, and local laws and regulations even though the food may not be readily marketable due to appearance, age, freshness, grade, size, surplus, or other conditions.

A donor making a charitable contribution of inventory must make a corresponding adjustment to the cost of goods sold by decreasing the cost of goods sold by the lesser of the fair market value of the property or the donor's basis with respect to the inventory. Accordingly, if the allowable charitable deduction for inventory is the fair market value of the inventory, the donor reduces its cost of goods sold by such value, with the result that the difference between the fair market value and the donor's basis may still be recovered by the donor as a business deduction other than as a charitable contribution.

To use the enhanced deduction, the taxpayer must establish that the fair market value of the donated item exceeds basis. The valuation of food inventory has been the subject of disputes between taxpayers and the IRS.

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[1] TAX RELIEF, UNEMPLOYMENT INSURANCE REAUTHORIZATION, AND JOB CREATION ACT OF 2010 Public Law 111-312, December 17, 2010.

[2] To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer, contributed to a charitable organization described in IRC section 501(c)(3) (except for private non-operating foundations), and the donee must: (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants; (2) not transfer the property in exchange for money, other property, or services; and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements. In the case of contributed property subject to the Federal Food, Drug, and Cosmetic Act, as amended, the property must satisfy the applicable requirements of such Act on the date of transfer and for 180 days prior to the transfer. The enhanced deduction is equal to the lesser of: (1) basis plus one-half of the item's appreciation (i.e., basis plus one-half of fair market value in excess of basis); or (2) two times basis.

California's Personal Income Tax Law (PITL) generally conforms to the federal rules relating to charitable contributions as of the specified date of January 1, 2009,[3] but specifically does not conform to the enhanced deduction for a contribution of food inventory.[4] The deduction under the PITL for charitable contributions of inventory is limited to the taxpayer's basis in the inventory, generally its cost. Additionally, the state's Corporation Tax Law (CTL) does not adopt the general federal rules that allow enhanced deductions for C-corporation contributions of inventory, and does not adopt the enhanced deduction for a contribution of food inventory. The deduction under the CTL for contributions of inventory is limited to the taxpayer's basis in the inventory (generally its cost), and may not exceed ten percent of the corporation's net income. Any excess may be carried forward for up to five years. [5]

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is working with the author's office to resolve these and other concerns that may be identified.

The definition of a qualified taxpayer as the person that is responsible for planting a crop, managing the crop, and harvesting the crop from land is silent on requiring the person to be engaged in the business of farming and specifying that the crop is the source of the donated fresh fruits or fresh vegetables. As a result, "qualified taxpayer" could be more broadly interpreted than the author intends.

This bill uses the undefined term, "fresh fruits or fresh vegetables." The absence of a definition to clarify this term could lead to disputes with taxpayers and would complicate the administration of this credit. For example would a qualified taxpayer that performed some on-site processing, i.e., washing, pasteurizing, flash freezing, and bagging or boxing fresh fruits or fresh vegetables, be eligible for the credit for donating these items?

Under the terms of this bill, two reports would be required because the initial report on credit utilization would be due in 2014 and the reporting requirement would become inoperative on January 1, 2016. Because of the timing of when returns are filed and processed, the initial report date in 2014 would allow that report to include data on the first year of the credit utilization, taxable year 2012, and the final required report would include complete data on taxable year 2013. If it is the author's intention that a report on credit utilization be required for each year that the credit could be generated, the author may wish to extend the duration of the reporting requirement.

[3] For taxable years beginning on or after January 1, 2010, R&TC section 17201 conforms to IRC section 170, relating to charitable contributions and gifts, as of the specified date of January 1, 2009, with modifications.
[4] R&TC section 17275.2.
[5] R&TC sections 24357–24359.1.

FISCAL IMPACT

Staff estimates one-time costs of approximately $67,000 in fiscal year 2011/2012 to develop, program, and test system changes in order to implement the credit that this bill would create. Historically these costs would be included as part of the department's annual change process. Due to the current fiscal environment and the redirection of resources to implement priority technology infrastructure projects, these costs are unable to be included in the normal annual change process.

The department would redirect resources from other revenue producing activities if necessary to implement this bill which could negatively impact existing revenue producing activities.

ECONOMIC IMPACT

Estimated Revenue Impact of AB 152 As Amended May 27, 2011 For Taxable Years Beginning On or After January 1, 2012 Enactment Assumed After June 30, 2011 ($ in Millions)			
2011/2012	2012/2013	2013/2014	2014/2015
-$0.2	-$0.2	-$0.4	-$0.4

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

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